

Introduction

The Office of Consumer Advocate (“OCA”) files this Post-hearing Brief to address a number of legal and policy issues regarding the imputation of the Verizon affiliate’s Yellow Pages revenue to the regulated telephone company, Verizon New Hampshire (“VNH”).

In this case VNH changed its affiliate contracts with its Yellow Page affiliate on January 1, 1999, and ended the revenue sharing arrangements with its directory publishing business. This change essentially reversed a regulatory policy of revenue sharing which had been in place in New Hampshire for 15 years.

After several rounds of testimony followed by several days of hearings it is clear to the OCA that strong policy and equity considerations support continuing this revenue sharing arrangement. Despite VNH’s claims that sweeping changes have occurred which required such a change in revenue sharing policy, OCA believes that the record supports a finding of only very modest and gradual changes in directory publishing. The record further demonstrates that VNH’s publishing affiliate continues to enjoy a huge share (**confidential** %) of the directory publishing revenues and extraordinary supra-profits.¹

Changes in the local telephone market mandated by the 1996 Telecommunications Act have not had a major impact on VNH’s Yellow Pages affiliate, and are irrelevant to this docket. If, and when, the level of competition in the New Hampshire local telephone market, for all customer segments, ever reaches a point where New Hampshire has real and significant competition, regulators may decide to remove price regulation. At that time, if it ever arrives, it might also be appropriate to revisit the imputation of publishing revenues.

¹ Hearings Exhibit 12, OCA Exhibits, p 168 (Confidential)

For now, as discussed in more detail below, the OCA finds the Commission Staff's ("Staff's") recommended imputation of directory revenues to VNH local telephone revenues an appropriate and necessary response to VNH's termination of its actual revenue sharing arrangements with its directory publishing affiliate.

I. Chronology of Events

August 11, 1982: Judge Greene of the Federal District Court concluded that the Bell Operating Companies (BOCs) should be allowed to retain publication of the Yellow Pages and its profits for the primary purpose of supporting local telephone service, and that those Yellow Pages revenues provided a "significant subsidy to local telephone rates." He also acknowledged that some competition existed among Yellow Pages providers.²

January 6, 1984: A contract for the publishing of telephone directories between New England Telephone (NET) and its directory publishing affiliate, NYNEX Information Resources Company (NIRC) was filed with the New Hampshire Public Utilities Commission ("Commission"), along with three other affiliate agreements. The Commission authorized NET to enter into the publishing agreement, which included a revenue sharing provision, but required NET to "provide ongoing updated information about changes in the terms and conditions of the contracts and the experience of the Company under the contracts."³ In a footnote, the Commission also stated that "an example of relevant updated information would be the income derived from Yellow

² United States of America v American Telephone and Telegraph Co., 552 F. Supp. 131, 193 (D. C. 1982).

³ New England Telephone and Telegraph Co., 70 N.H.P.U.C. 630 (1985) (Order 17,744 issued July 12, 1985.)

Pages. If that income had been significantly underestimated, it would be appropriate to consider further regulatory measures.”⁴

July 12, 1985: The Commission issued Order 17,744 at the completion of the rate investigation in docket DR 84-95. In that order, the Commission found the costs associated with the four agreements filed in January 1984 to be appropriate and incorporated them into NET’s revenue requirement, and, thereby, included their costs in rates.⁵

September 28, 1988: The Commission issued Order 19,188 authorizing NET to expand its marketing of white pages to third parties. The Commission found that “the revenues from such marketing efforts will contribute toward the public good by diminishing the revenue burden on basic local rates”, consistent with previous rulings minimizing local rates by inclusion of directory revenues in NET’s revenue requirement.⁶

November 13, 1990: NET filed with the Commission five new directory publishing agreements between itself and NIRC. Those agreements provided, among other things, continued revenue sharing. The Commission approved the agreements in Order 20,074.⁷

1992: NIRC established a new, wholly-owned subsidiary, NYNEX Information Technologies Company (NIT) to handle electronic publishing, while Bell Atlantic provided electronic publishing services through another subsidiary, Bell Atlantic

⁴ Id.

⁵ Id. at 631.

⁶ New England Telephone and Telegraph Co., 73 N.H.P.U.C. 390 (1988).

⁷ New England Telephone Co., 76 N.H.P.U.C. 130 (1991).

Electronic Publishing, Inc. (BAEP).⁸ Printed directories for NYNEX continued to be provided by NIRC, while Bell Atlantic published print directories through the departments in their telephone companies.

August 29, 1994: The FCC released a Memorandum Opinion and Order stating, “If a carrier provides services to its directory publishing affiliate and receives compensation . . . it may record all such revenues in its Part 32 accounts.” Further, the FCC stated that, “[t]he revenues associated with the publication of Yellow Pages directories by an affiliate may not be recorded on the carrier’s books.” It went on to say, however, that “[s]tates, however, may have the authority to impute revenues related to affiliate publishing of Yellow Pages directories for state ratemaking purposes.” (Emphasis added.)⁹

February 1996: The United States Congress passed the Telecommunications Act of 1996 (TAct). Included in the TAct were the sections upon which VNH relies in its arguments in this docket: §254 Universal Service; §222(e) Subscriber List Information; and §274 Electronic Publishing by Bell Operating Companies.

January 1, 1997: NYNEX transferred ownership of NIT (the electronic publishing company) from NIRC to NYNEX Corporation to qualify NIT as a separated affiliate under section 274(i)(9) so that it could continue to engage in electronic publishing pursuant to section 274(a).¹⁰

⁸ Direct Testimony of ChristiAne Mason, p. 9, line 1.

⁹ Local Exchange Carriers’ Permanent Cost Allocation Manuals for the Separation of Regulated and Nonregulated Costs, FCC Docket, Rcd 476185 (AAD 92-22 through 92-35)

¹⁰ 47 U.S.C. 274 (1996).

August 14, 1997: As a result of the Bell Atlantic/NYNEX Merger, NIRC (NYNEX's print directory company) changed its name to Bell Atlantic Yellow Pages Company, Inc. (BAYPC), and NIT (NYNEX's electronic publishing company) changed its name to Bell Atlantic Electronic Commerce Services, Inc. (BAECS).

December 29, 1997: BAYPC gives written notice to Bell Atlantic-New England (BA-NE) of its intent to terminate the Directory Licensing Agreement (DLA) effective January 1, 1999. The DLA provided the terms of the Yellow Pages revenue-sharing between BAYPC and BA-NE, and ultimately determined the amount of Yellow Pages revenues recognized by the NH Commission in setting Bell Atlantic-New Hampshire's (BA-NH) revenue requirements.¹¹

The Maine Commission was informed of this notice of termination, as was statutorily required. The Rhode Island Commission was also informed via an informational letter dated November 19, 1999, even though that state has no such statutory requirement.¹² This Commission, however, was not advised of this notice of termination in any way, since VNH neither filed the notice, nor advised the Commission in any other manner, either formally or informally, of the Company's unilateral actions. This lack of notice was in direct contrast to how some other Commissions were treated.¹³

¹¹ Direct Testimony of ChristiAne Mason, page 10, line 8.

¹² Direct Testimony of ChristiAne Mason, Attachment CGM-5.

¹³ Re New England Telephone and Telegraph Co. dba Bell Atlantic-Vermont No. 6167, Re AT&T Communications of New England, Inc., No. 6189 (Vt. P.S.B. Mar. 24, 2000) (the Public Service Board was displeased that Bell Atlantic ignored their requests for a copy of the Directory License Agreement.)

December 23, 1998: BAYPC and NET amended the 1991 DLA for all New England states except Maine, for effect January 1, 1999.¹⁴ Once again, no filing was made with the Commission, nor was it advised in any other manner of the amendment.

December 24, 1998: BAYPC withdrew the December 29, 1997 termination of the DLA and issued a new notice of termination of the DLA, as amended on December 23, 1998, effective January 1, 2000. Once again, VNH failed to notify the Commission in any way of its actions.¹⁵

January 1, 1999: VNH stopped recording Yellow Pages directory revenue sharing in its financial reports to the Commission.¹⁶

January 1, 2000: BAYPC again extended the termination date of the DLA until March 31, 2000. Again, VNH failed to notify the Commission of its actions.¹⁷

January 14, 2000: The new Directory Publishing Agreement (DPA) and Listings Licensing Agreement (LLA) were signed, with the agreements retroactively effective to January 1, 2000.¹⁸

February 28, 2000: The separation provisions (for print and electronic publishing operations) of section 274 of TAct expire.¹⁹

¹⁴ Transcript, Day I, p. 13, line 20.

¹⁵ Transcript, Day I, p. 13, line 23.

¹⁶ Transcript, Day I, p. 43, line 3.

¹⁷ Transcript, Day I, p. 14, line 3.

¹⁸ Direct Testimony of ChristiAne Mason, p. 11, line 1.

¹⁹ 47 U.S.C. Section 274 (1996).

March 8, 2000: VNH filed the DPA and LLA with the Commission. VNH's cover letter failed to disclose any impact by the new agreements on the 15-year old directory revenue-sharing policy of the Commission.²⁰

October, 2000: VNH's Yellow Pages publishing affiliate was re-merged with VNH's Electronic Publishing affiliate.²¹

II. Verizon's Unilateral Attempt to Change the Regulatory Treatment of Yellow Pages Revenues in New Hampshire is Not Supported by State or Federal Law

A. Verizon provides Telephone Directories as part of its Regulated Activity.

Under RSA 374:3, the Commission is authorized to regulate and control public utilities in New Hampshire. The Commission is the arbiter "between the interests of the customer and the interests of the regulated utility."²² This authority extends to plenary ratemaking powers over public utilities under RSA 378:7. Verizon is a public utility offering regulated telecommunications services in New Hampshire and its rates are set through traditional rate of return regulation.

The Commission's rules require every telephone utility in New Hampshire to provide a published telephone directory to each of its customers at least once a year.²³ The directory listing services are also described in VNH's local exchange tariff and each customer is allowed one alphabetical listing without additional charge as part of basic

²⁰ Direct Testimony of ChristiAne Mason, p. 7, line 7 – p. 12, line 13.

²¹ Exhibit 11, Verizon Record Request 1 from hearing.

²² RSA 363:17-a.

²³ N.H. Code Admin. R. P.U.C. 405.04 (1997).

local telephone service.²⁴ VNH's provision of the required telephone directories is regulated and its costs are included within VNH's basic telephone tariff. Finally, the Commission has traditionally considered the directory publishing, including Yellow Pages costs and revenues, as part of the ratemaking process in setting basic telephone rates.²⁵

B. Verizon's Unilateral Changes to its Affiliate Agreements were Not Fully Explained to the Commission and were Contrary to Established New Hampshire Law.

In the 1982 Court Decision breaking up AT&T, the Court determined that it was not in the public interest to prohibit the local telephone companies from directory and Yellow Pages publication. Judge Greene concluded that this was because "[a]ll those who commented on or have studied the issue agree that the Yellow Pages provide a significant subsidy to local telephone rates. This subsidy would likely continue if the Operating Companies were permitted to continue to publish the Yellow Pages."²⁶ As a result, the local BOC's, or their affiliates, have continued to publish both telephone directories and Yellow Page listings despite the break-up of AT&T. The BOC's freedom to publish directories and Yellow Pages continued under the TAct, as did the competitive nature of directory publishing.

In New Hampshire, the Commission allowed the directory publishing business to be conducted by an affiliate, NIRC, in 1984, but established the revenue sharing arrangement.²⁷ In fact, Judge Greene, in a subsequent opinion on the AT&T break-up

²⁴ VNH Tariff 83 Section 5.6.1.

²⁵ New England Telephone and Telegraph Co., 65 N.H.P.U.C. 564, 578 (1980) (Commission used directory advertising revenues to determine regulated telephone company income.)

²⁶ United States v. American Telephone and Telegraph Co., 552 F. Supp. 131, 193-94 (D. D.C.1982).

²⁷ Transcript, Day IV, p. 13, lines 2-16.

expressed concern over the conduct of Yellow Page publishing activities by affiliates because of the opportunity for affiliates to funnel publishing and advertising profits away from the local exchange companies and deprive ratepayers of the benefits intended by the court's earlier decision.²⁸ The Commission in its 1984 order concerning the publishing affiliate took action to preserve the value of the publishing business for the New Hampshire ratepayers in order to prevent the type of erosion of benefits that Judge Greene was concerned about. Although VNH now argues that it transferred the yellow pages publishing business to its affiliate in 1984, that argument does not prevent the Commission from continuing to preserve the value of Yellow Pages publishing activity for ratepayers. In fact, other jurisdictions have undone the economic effect of such attempted transfers in order to provide continued benefits to ratepayers.²⁹

The TAct did nothing to prohibit continued state regulation of the directory and Yellow Page publishing activities of the local BOC's, any more than it prohibited local regulation of basic telephone service even after it has been declared competitive.³⁰ The Commission retains authority under its state ratemaking statutes to continue to require Yellow Pages revenue to be included in regulated basic telephone rates.

²⁸ United States v. Western Electric Company, Inc., 592 F.Supp. 846, 865-866 (D. D.C. 1984).

²⁹ New England Telephone and Telegraph Co., 157 P.U.R.4th 112, 165 (1994) (Public Service Board reduced BOC revenue requirement to account for Yellow Page revenue following transfer to publishing affiliate.); South Central Bell Telephone Co., 121 P.U.R.4th 338 (1991)(Public Service Commission included Yellow Pages revenues in regulated revenues in order to preserve for ratepayers the benefits of directory publishing following transfer of activities to affiliate.); Qwest Communications International, Inc., No. SPU-02-15, p. 3 (Iowa U.B. Sept. 4, 2002) (Utilities Board will not allow transfer of directory publishing activities unless utility waives any future arguments against imputing directory profits back to regulated revenues as if transfer had not occurred); Bell Atlantic-New Jersey, Inc., No. T09710076 (N.J.B.P.U. Mar. 3, 1998) (Board of Public Utilities held that restructuring of directory publishing did not preclude it from imputing publishing revenues to regulated utility in future rate proceedings and required quarterly reporting).

³⁰ 47 U.S.C. §271 (1996).

The new affiliate arrangement put in place by VNH on December 31, 1998, continued to give the VNH competitive affiliate the right to publish directories and to bundle them with the Yellow Pages, but did not provide for any sharing of Yellow Page revenues with VNH. Beginning in January 1999, VNH filed monthly and annual reports with the Commission which evidenced the substantially reduced Yellow Pages revenues in regulated account 5230. An independent audit by Liberty Consultants in September 2002, estimated that the revenue impact from loss of Yellow Pages revenue in New Hampshire in 2000 was a \$24,000,000 reduction. Although VNH's modification of its affiliate contract greatly impacted regulated revenues, VNH made this change without first highlighting the revenue impact to the Commission.

In fact, VNH took measures to avoid clarifying its actions and their impact in its responses to questions by Staff member, Minot Hill, in his desk audit of VNH's 1999 monthly and quarterly financial reports. When Mr. Hill queried a drop in Miscellaneous Revenues (52XX, 71XX), VNH replied to Question 6, "a) . . . [t]he average for the 12 months looks reasonable", and referred to an adjustment in the December 1999 report for "Rent Revenues". When queried again in Question 8 regarding the drop in Miscellaneous Revenues, where Mr. Hill said, "[p]lease provide the reasons for these decreases, and also provide the expected amount of decreases for these revenue accounts for the calendar year 2000", VNH responded, "[t]he decrease in revenues during the second half of 1999 occurred in . . . Miscellaneous Revenues. These decreases have been explained in our response to question 6."³¹ VNH's very narrowly designed responses did not answer Mr. Hill's questions; much less provide full, transparent explanations.

³¹ Rebuttal Testimony of John Nestor, Appendix C, p. 8-9.

Following the MCI, Qwest, and Global Crossing financial debacles, Verizon Communications was among those companies scrambling to assure stockholders of its integrity in financial reporting. In its 2002 Annual Report to Stockholders, in a Q&A on page 8, entitled, “Straight Talk from Ivan Seidenberg”³² a question is posed, “[w]hat assurances can you give investors that the ethical problems that have plagued some other companies will not affect Verizon?”. Mr. Seidenberg’s reply is, “Verizon’s core values of integrity and respect are a fundamental part of our culture. We have one of the most rigorous codes of conduct in corporate America, which applies to all employees worldwide. . . . We train and certify all our employees on their understanding of compliance and ethics issues.”³³ (emphasis added) Further, Mr. Seidenberg recorded an ad for the New York Stock Exchange touting Verizon’s support for “Full Transparency” in all of its financial reporting.

When questioned about these comments, VNH responded that it “responds to data requests . . . in the spirit of cooperation . . .”³⁴ Given the very narrow answers received by Mr. Hill, it is clear that VNH was neither “fully transparent”, nor was it displaying “integrity” and “cooperation” in disclosing to Mr. Hill and Staff the financial impact of its actions in terminating the Yellow Pages revenue sharing contract.

Mr. Hill already had a dilemma in understanding the impacts to VNH revenues for 1999 caused by VNH’s introduction of a number of revenue reducing tariffs and other programs such as Extended Area Service (“EAS”) in 1997, 1998 and 1999 in response to the stipulation with staff to reduce VNH overearnings by \$26.4 million annually. Rather than assist Mr. Hill in determining what was really going on, VNH chose to compound

³² Ivan Seidenberg is CEO of Verizon Communications.

³³ Verizon Annual Report to Stockholders, p 8.

³⁴ Exhibit 12, OCA Exhibits, p. 44 (OCA 2-9).

Mr. Hill's dilemma by avoiding the real, needed clarification – the financial impact of the publishing affiliate arrangements. The overriding question in evaluating VNH's actions is simply put, "doesn't the Commission have a right to the same level of honesty, integrity and transparency as Verizon promises its shareholders?"

Having demonstrated that VNH unilaterally and without proper assistance to the Commission in evaluating financial impacts, changed a long standing regulatory practice regarding publishing revenues, we turn now to the Commission's power to respond to these actions. Under RSA 365:5, the Commission may:

investigate or make inquiry in a manner to be determined by it as to any rate charged or proposed or as to any act or thing having been done, or having been omitted or proposed by any public utility; and the commission shall make such inquiry in regard to any rate charged or proposed or to any act or thing having been done or having been omitted or proposed by any such utility in violation of any provision of law or order of the commission. (Emphasis added.)

RSA 374:26 authorizes the Commission to determine whether a proposed utility action:

...would be for the public good, and not otherwise; and may prescribe such terms and conditions for the exercise of the privilege granted under such permission as it shall consider for the public interest.

As the New Hampshire Supreme Court has recognized, the Commission is authorized to require a utility to seek Commission approval before proceeding with certain proposed actions.³⁵ The Commission also has authority to investigate how the new affiliate contract will affect regulated revenues and may modify any affiliate agreement if it finds it unjust or unreasonable:

³⁵ Appeal of Easton, 125 N.H. 205 (1984) (the Commission must "determine whether, under all the circumstances the financing is in the public good – a determination which includes considerations beyond the terms of the proposed borrowing.") Public Service Company of New Hampshire, 86 N.H.P.U.C. 756 (2001) (in authorizing PSNH to refinance certain pollution control bonds, under RSA 369:1, the Commission may attach "such reasonable terms and conditions [to its approval] as the commission may find to be necessary in the public interest." Id. at 760.)

The commission shall have full power and authority to investigate any such contract, arrangement, purchase, or sale and, if the commission after notice and hearing shall find any such contract, arrangement, purchase, or sale to be unjust or unreasonable, the commission may make such reasonable order relating thereto as the public good requires. In any such investigation, the burden shall be on the public utility and affiliate to prove the reasonableness of any such contract, arrangement, purchase, or sale with, from, or to an affiliate. If the public utility shall fail to satisfy the commission of the reasonableness of any such contract, arrangement, purchase, or sale, the commission may disapprove the same and disallow payments thereunder or such part of any such payment as the commission shall find to be unjust or unreasonable.... RSA 366:5

VNH has argued that this statute limits the Commission's authority to craft a remedy and only allows the Commission to disallow payments to the affiliate. Such a reading, however, is overly narrow and contrary to the clear intent of the statute. The statute allows the Commission to review and issue such orders concerning an affiliate contract as the public good requires. Other states have found that similar statutory language allows the remedy of imputation of revenues from publishing affiliates to incumbent telephone carriers.³⁶

VNH has also argued that ratepayers must share in both the profits and losses of Yellow Pages and that therefore the Commission must impute both profits and losses of the Yellow Page operation to VNH. While OCA generally supports a balanced approach between utility and ratepayer interests, VNH's arguments on this point ignore several facts. First, the yellow page operation in New Hampshire has been highly profitable since the first revenue sharing was put in place twenty years ago. Second, the Commission has the authority and obligation to ensure that VNH conducts its activities prudently and therefore may require the termination of arrangements which are not

³⁶ See, US West Communications, Inc. v. Washington Utilities and Transportation Comm., 949 P.2d 1337, 1348 (1998).

profitable to ratepayers. There is simply no requirement that the Commission keep the benefits of yellow page publishing for ratepayers if that business is not profitable. The revenue imputation by Staff does balance utility and ratepayer interests by allowing the utility to cover its costs of directory publishing and to earn a reasonable portion of its profits as well. If the Commission decides to impute Yellow Pages revenues it would need to provide for annual reporting and Commission review of the Yellow Pages revenue and operations to ensure that appropriate revenue levels are imputed.

The Commission, through its prior orders in 1984 and 1991, established a regulatory policy with respect to sharing Yellow Page revenues with VNH. So long as the Commission finds that a contribution of Yellow Page advertising revenues to VNH is reasonable and meets the public good requirement, RSA 366:5 provides the Commission with authority to impute revenues in order to continue that policy.

By terminating the revenue sharing arrangement between its competitive affiliate and its regulated telephone company, VNH has attempted to contravene established policy. While existing regulatory policy may be changed, it is the Commission and not the regulated utility which must institute the change.

[T]he Company is obligated, if it seeks to change existing regulatory policy, to bring to our attention any new considerations it believes may warrant the change. This is to be done in an open, public proceeding where the sworn, cross-examined testimony and evidence, not just of the Company but of all parties, forms an evidentiary record.³⁷

VNH failed to petition the Commission to change existing policy. In that case an open forum would have allowed interested parties to offer testimony on the proposed policy change. Instead, the Commission has been forced to institute this docket in order

³⁷ Pacific Corp., dba Utah Power and Light Co., 201 P.U.R.4th 467, 487 (2000).

to reinstate the regulatory policy that it has never changed. As discussed below, VNH has provided no convincing legal or policy basis for changing New Hampshire regulatory policy toward Yellow Page revenue.

C.1996 Telecommunications Act has Not Changed the Appropriate Regulatory Treatment of Yellow Page Revenues.

VNH asserts that imputation of Yellow Page revenues to VNH is inconsistent with sections 222 (e), 254 and 274 of the TAct. Section 222 (e) requires the incumbent telephone carrier, in this case VNH, to provide directory listings “on a timely and unbundled basis, under nondiscriminatory and reasonable rates, terms, and conditions.”³⁸ VNH complied with this section both before and after it terminated its revenue sharing arrangement with its publishing affiliate. Section 222(e) does not address publication contracts, nor does it prohibit revenue sharing between competitive Yellow Pages publishing affiliates and their regulated telephone affiliate. Section 222(e) merely deals with BOC’s obligations to share listings information on equal terms. Thus, the Commission is free to require VNH and its publishing affiliate to share Yellow Pages revenue.³⁹ VNH argues that the Federal Communications Commission (“FCC”) Third Report and Order, CC Docket No. 96-115 released September 9, 1999, prohibits Yellow Pages revenue imputation. This argument completely misses the point. Neither the order, nor case law cited therein even addresses the issue.

VNH claims that under section 254 the Commission’s revenue imputation is a “contribution to universal service.” Section 254(f) provides that:

³⁸ 47 U.S.C. § 222(e) (1996)

³⁹ New England Telephone Co., 76 N.H.P.U.C. 130 (1991). (The Commission approved five new revenue sharing agreements between NET and NIRC.)

A state may adopt regulations not inconsistent with the Commission's rules to preserve and advance universal service. Every telecommunications carrier that provides intrastate telecommunications services shall contribute, on an equitable and non-discriminatory basis, in a manner determined by the State to the preservation and advancement of universal service in that State.

This section requires that VNH contribute to universal service. There is nothing in the statutory language that prohibits the imputation of Yellow Pages revenues. Further, this section deals specifically with telecommunications carriers and not with directory publishers. VNH has failed to cite any reported case or regulatory proceeding in which Yellow Pages revenue imputation has been prohibited by section 254 and in fact no case law or FCC decisions support VNH's arguments under section 254.

VNH asserts that section 274 also prohibits revenue imputation. This claim has no merit. Section 274 deals with electronic publishing activities by a local Bell operating company. Specifically, section 274(a) provides that:

No Bell operating company or any affiliate may engage in the provision of electronic publishing that is disseminated by means of such Bell operating company's or any of its affiliates' basic telephone service, except that nothing in this section shall prohibit a separated affiliate or electronic publishing joint venture operated in accordance with this section from engaging in the provision of electronic publishing.

Under section 274(b), "a separated affiliate or electronic publishing joint venture shall be operated independently from the Bell operating company." Thus, BOC's such as VNH were free to engage in electronic publishing in either of two ways, through a separated affiliate or through an electronic publishing joint venture operating in accordance with section 274.

On January 1, 1997, NYNEX transferred ownership of NIT (its electronic publishing affiliate) from NIRC to NYNEX Corporation. That transfer qualified NIT as a

“separated affiliate” as defined by section 274(i). Section 274(g) required compliance with the separated affiliate requirements of 274(a) on or before February 8, 1997. By completing the transfer of NIT on January 1, 1997, VNH complied with the requirements of section 274(a) which allowed separated affiliates of Bell Operating Companies to engage in electronic publishing.

While it is true that VNH could also have made changes to conduct itself as an “electronic publishing joint venture” under section 274(i)(5), it did not need to since NIT was already in compliance as a “separated affiliate.”⁴⁰ Under the facts of this case, the revenue sharing arrangement between NIRC and VNH did not violate section 274 because VNH was not part of an electronic publishing joint venture and was already complying with section 274 by conducting its electronic publishing through NIT, as a separated affiliate.

Finally, section 274 sunset on February 8, 2000, a full month before VNH filed the new affiliate agreements with the Commission. Hence, this section no longer prohibits VNH’s use of any affiliate arrangement this Commission deems appropriate.⁴¹ A number of courts and regulatory commissions have required imputation of revenues from Yellow Pages publishing affiliates to incumbent telephone companies since passage of the Tact and none of those tribunals have found that sections 222(e), 254, or 274 prohibited such imputation.⁴²

⁴⁰ If VNH and its affiliates had chosen to operate as an “electronic publishing joint venture” they would have been subject to a 50% limitation on revenue sharing under section 47 U.S.C. 274(c)(2)(C) (1996).

⁴¹ See, 47 U.S.C. §274 (g) (1996).

⁴² See, Verizon California Inc., No. 01-09-001, 01-09-002, 03-02-073 (Cal. U.U.C. Feb. 27, 2003); Qwest Communications International, Inc., No. SPU-02-15 (Iowa U.B. Sept. 4, 2002); US West Communications, Inc. v. Public Service Comm’n. of Utah, 998 P.2d 247 (2000); Bell Atlantic – Maine, No. 2000-132 (Me. P.U.C. Jun. 13, 2000); US West Communications, Inc. v. Washington Utilities and Transportation Comm’n., 949 P.2d 1337 (1998); US West Communications, Inc., No. UT-980948 (Wash. U.T.C. Jul. 27,

III. Verizon's Unilateral Attempt to Change Regulatory Policy regarding Yellow Page Revenues in New Hampshire is Not Supported by Sound Policy Principles.

A. The Policy Considerations that Existed at the Time of the AT&T Divestiture Continue to Exist Today in New Hampshire.

When Judge Greene issued his decision to keep Directory Publishing activities including Yellow Page advertising with the local BOC's he acknowledged that competitors to the BOC's Yellow Pages existed. He also noted, however, that "[a]ll parties concede that the Yellow Pages currently earn supra-competitive profits."⁴³ The record in this proceeding demonstrates that despite the passage of time, as well as significant federal legislation (TAct), not much has changed in the Yellow Pages industry.

In fact, Verizon's Yellow Page affiliate has at least a 70% share of the New Hampshire Yellow Pages print market based on Staff Witness Schlegel's conservative estimates.⁴⁴ In addition, incumbents such as VNH nationally retain an (**redacted**) % share of Yellow Page revenues.⁴⁵ Those numbers do not support a conclusion that the directory advertising market is fully competitive. Were competition in the Yellow Pages market truly robust, Verizon's Yellow Page affiliate would not have shown the type of gross revenue growth in New Hampshire from \$52,542,000 in 1995 to \$67,826,000 in 2003 – while maintaining the supra-profits approaching 50% of gross revenues (2002:

2000); Cincinnati Bell Telephone Co., 190 P.U.R.4th 585 (1999); and Bell Atlantic-New Jersey, Inc., No. T09710076 (N.J.B.P.U. Mar. 3, 1998).

⁴³ American Telephone and Telegraph, at p. 193.

⁴⁴ Direct Testimony of Chris Schlegel, p 21, lines 17-18.

⁴⁵ Hearing Exhibit 12, OCA Exhibits, p 168 (Confidential)

49.3%, 2003: 49.1%., for example).⁴⁶ Similarly, were competition a valid issue, VNH would not have been able to increase Yellow Page advertising prices year-after-year from 1998 through 2002, with the increase from 2001 to 2002 approaching 5%.⁴⁷

In 1982, Verizon was the dominant player in NH's market; it remains the dominant player today.

B. There Is No Need to Demonstrate Verizon's Market Power in Order to Support Yellow Page Revenue Sharing Requirements.

It is VNH's ability to combine the Yellow Page advertising with the regulated white pages directory service which supports the requirement that these related revenues be contributed to the regulated telephone service. It is the value contributed to the Yellow Page business, by combining it with the regulated directory activity, which regulators have captured by requiring a sharing of profits after recovery of a reasonable return. That value, absent an arms length sale of those rights to a third party, is difficult to determine with any certainty.

Without giving a specific number to the value of the affiliation, however, the record in this case supports a significant value for the affiliation of Yellow Pages with VNH's regulated telephone service. For example, each telephone book containing Yellow Pages has BOC's current name emblazoned on its cover. When Verizon was NYNEX, the cover read, "NYNEX Yellow Pages".⁴⁸ The 2003 phone book has VNH's

⁴⁶ Attachment 1 to the Post-Hearing Brief: Verizon Information Services Presentation by Kathy Harless, January 29, 2004.

⁴⁷ Hearings Exhibit 40.

⁴⁸ Hearings Exhibits 30 and 31.

name and logo clearly evident on its cover in Verizon's red, black, and white colors.⁴⁹ In fact, the BOC has even used the cover to inform telephone book users of its name changes – the 2000 book's cover has "BELL ATLANTIC IS NOW VERIZON" boldly shown in red and white.⁵⁰

In this latter phone book, VNH highlights a link between its 1998 virtual monopoly and Yellow Pages effectiveness. It reports usage of Verizon Yellow Pages by 93% of Manchester area adults, with 90% in the past year, 80% in the past month, and 60% in the past week, and compares that with usage of all other competitive phone books (17%, 9%, and 3% over the past year, month, and week, respectively).⁵¹ With VNH providing 85% of the telephone service in the state and 85% of the phone books, the close link between the provider of telephone service to the overwhelming majority of telephone users in the state and the provider of telephone phone books to the overwhelming majority of phone book users in the state is clear.

Although VNH made numerous claims in the course of this docket that there is little or no value to that combination, its claims in its own telephone books contradict those claims.⁵² In order to establish or to continue a regulatory policy, however, it is not necessary for this Commission to ascertain the value of the combination of Yellow Pages and VNH's regulated directory services. Rather, if it has a reasonable basis for finding that value exists in the combination, the Commission may require the revenue sharing arrangements.

⁴⁹ Hearings Exhibit 28.

⁵⁰ Hearings Exhibit 29.

⁵¹ Hearings Exhibit 29, p. SOA-3

⁵² Hearings Exhibits 30, p2. Hearings Exhibit 29, p. SOA-1.

If Verizon does not find value in combining its yellow page advertising business with its directory publishing business it may cease that combination. VNH is not required to provide the regulated directory services or the Yellow Page advertising services through its own affiliates. It may contract for those services through third parties. As a result, if Verizon finds that there is no value in combining these operations it is free to structure its businesses in a different way.

C. The Record Supports a Finding that Verizon Holds Market Power and that the Yellow Pages Advertising Business in New Hampshire Is Not Competitive.

Staff witness Schlegel provided analysis of the Verizon publishing affiliate's Yellow Pages market power in New Hampshire. Mr. Schlegel defined the product market for Yellow Pages publishing to include all print Yellow Page advertisers. Contrary to VNH witness, Mr. Taylor, Mr. Schlegel found that the relevant market did not include other forms of advertising such as newspapers, television, or cable TV.⁵³ The lack of product substitution with those other print media is evident from both Yellow Page customer statements⁵⁴ and Verizon Yellow Page affiliates' own advertising claims.⁵⁵ Further, when defining the product market for Yellow Pages advertising, the Eleventh Circuit Court of Appeals agreed with Mr. Schlegel that the competitive product market for BOC Yellow Pages is all yellow pages print publishers.⁵⁶ Mr. Schlegel then determined that the geographic market for Yellow Pages was local and corresponded

⁵³ Schlegel Testimony September 8, 2003 p. 10.

⁵⁴ Schlegel Testimony September 8, 2003 p. 12-13.

⁵⁵ Attachment 1 to the Post-Hearing Brief: Verizon Information Services Presentation by Kathy Harless, January 29, 2004, p. 5. Hearings Exhibit 29.

⁵⁶ Ad-Vantage Telephone Directory Consultants, Inc., v. GTE Directories Corp., 849 F.2d 1336, 1342 (11th Cir. 1987).

roughly to the area served by each printed directory.⁵⁷ Based upon this market definition, Mr. Schlegel reached a conservative estimate of the Verizon publishing affiliate's Yellow Pages market share in New Hampshire to be 70%. Mr. Schlegel concluded that the Verizon publishing affiliate has market power.⁵⁸

Evidence of this market power is found in both usage advantages and pricing disparities between the Verizon publishing affiliate and its competitors. In a recent national study, results showed that directories published by telephone companies averaged 6.24 references per household per month as compared with 1.32 references for independent directories.⁵⁹ Finally, Mr. Schlegel determined that the Verizon publishing affiliate was able to price its Yellow Page advertising at twice the price of its competitors without losing significant customers and was able to increase prices on a yearly basis.⁶⁰ Given this analysis and the evidence supporting it the Commission may safely conclude that the Verizon publishing affiliate continues to hold market power and continues to enjoy supra-competitive profits in its New Hampshire Yellow Pages business.

The record supports a finding that Verizon Yellow Pages enjoys market power in New Hampshire; therefore VNH's claims that imputation of yellow pages revenues would create market distortions in the Yellow Pages publishing market are baseless. In a non-competitive Yellow Pages market, distortions in favor of the dominant provider are irrelevant.⁶¹ The same argument applies with regard to VNH's claims of distortions to the local exchange market. The local exchange market in New Hampshire, while open to

⁵⁷ Schlegel Testimony September 8, 2003 p. 20.

⁵⁸ Schlegel Testimony September 2003 p. 21.

⁵⁹ Schlegel Testimony September 2003 p. 23.

⁶⁰ Schlegel Testimony September 2003 p. 24-25

⁶¹ Further, since Staff has proposed the remedy of imputation there will be no distortion of Verizon Yellow Pages profits since it will retain all of those profits in its publishing operations. Imputation will only effect the level of regulated rates charged.

competition, is still dominated by VNH in New Hampshire and is subject to price regulation. (Verizon retains 85% of the access lines in its New Hampshire service territory.) As a result, the local exchange market has not yet reached a point where the Commission has found it necessary to analyze the impact of regulated local rates upon competition. If and when that point is reached, the Commission may, in an appropriate ratemaking docket, consider potential market distortions. That issue is not the topic of this docket, however, and no record exists in this proceeding to conduct that analysis.

IV. Imputation of Verizon Yellow Pages Revenue to the Regulated Telephone Operation in New Hampshire is Appropriate and is Consistent with its Treatment in Many Other Jurisdictions.

As discussed earlier, RSA 366:5 authorizes the Commission to investigate the arrangement between VNH and its affiliate and to modify that arrangement if it is not for the public good. The Commission has never regulated Yellow Pages publishing; however, simply because a utility conducts a specific unregulated activity does not mean that the revenues from that activity cannot be used for ratemaking. This is the case in other jurisdictions as well. In State ex rel. Util. Comm'n v. Carolina Telephone and Telegraph Co., 61 N.C. App. 42, 300 S.E. 2d 395 (1983), the Court held that the Commission properly included the "...gross revenues and expenses on three grounds: (1) that the furnishing of classified advertising by a telephone company is an essential part of the service it provides; (2) that there was an insufficient demonstration of competition for advertising revenue in the evidence presented; and (3) that this Court's judgment should not be substituted for the Commission's where the Commission's order is supported by a

reasonable construction of the evidence.”⁶² The imputation of non-regulated Yellow Pages revenues to the regulated provider utility has been upheld by a number of other jurisdictions.⁶³ In fact despite utility attempts to transfer publishing assets, profits from an affiliate’s Yellow Pages operations are a utility’s assets and subject to regulation, and may be imputed to determine telephone rates.⁶⁴ As part of its ratemaking authority and in order to properly balance ratepayers’ and shareholders’ interests, the Commission may impute Yellow Pages revenues in determining rates.

Whether Verizon witness O’Quinn’s testimony regarding the recording of Yellow Page shared-revenue has merit is not relevant to the Commission’s decision in this docket. If O’Quinn is correct in his inability to directly record such revenue on the books of VNH because of GAAP, VNH still retains the ability to report the amount of the shared revenue to the Commission. The Commission can then use that data to adjust VNH’s Annual Report in its internal analyses of earnings and rate of return spreadsheets to reflect that additional revenue.

⁶² Id., 61 N.C. App. at 44, 300 S.E.2d at 397, citing Util. Comm’n and The New Telephone Co. v. Central Telephone Co., 60 N.C. App. 393, 299 S.E.2d 264 (1983). State ex re. Util. Comm’n v. Southern Bell Telephone and Telegraph Co. 307 N.C. 541, 299 S.E. 2d 763. (1983) (upholding the Commission’s decision to include expenses, revenues, and investments relating to Yellow Pages advertising in setting rates.); In re: Rates and Charges of the Mountain States Telephone and Telegraph Co. Mountain States Telephone and Telegraph Co. v. Corporation Commission, 653 P.2d 501. (the Commission may include earnings, investments, and expenditures that are “used or useful” in providing telephone services, and because Yellow Pages advertising is “used and useful”, it may be considered in determining rates.)

⁶³ See all cases cited in footnotes 29, 42 and 64.

⁶⁴ US West Communications v. Public Service Comm’n of Utah, 998 P.2d 247 (2000) (although a telephone directory publishing business is not intrinsically a public utility, the assets from such a business are deemed public utility assets and therefore subject to regulation.); In re: Rates and Charges of US West Communications, Inc. The State v. Corporation Comm’n and U.S. West Communications, Inc., 121 N.M. 156, 909 P.2d 716 (1995) (upholding the Commission’s decision to impute Yellow Pages revenues under a New Mexico constitutional provision requiring the Commission to consider earnings, investments, and expenditures for imputation purposes.); In re: Rochester Telephone Co. v. Public Service Comm’n, 87 N.Y.2d 17, 660 N.E. 2d 1112, 637 NYS2d 333 (1995) (upholding the Commission’s decision to impute for ratemaking purposes, the telephone utility’s revenues from its unregulated affiliate in the form of a 2% royalty); Petition of Northwestern Bell Telephone Company, Minneapolis, Minnesota for Authority to Change its Schedule of Telephone Rates, 417 N.W.2d 274, 286 (1987) (hypothetical revenues resulting from the sale of its telephone directory service may be imputed.)

V. Conclusion

There is no basis in either law or policy for VNH to retain the profits from its New Hampshire Yellow Pages advertising. The value of the Yellow Page advertising business was developed with ratepayer funds and the value of Yellow Page advertising continues to be dependent upon the still dominant customer base of VNH. As one commission put it so well, “[a]pproximately 17 years of corporate restructuring efforts to divorce directory publishing profits from the local exchange service business and to put that money into shareholders’ pockets rather [sic] than ratepayers’ pockets have not succeeded. Those profits continue to benefit the local exchange service portion of [the incumbent telephone company].”⁶⁵

The agreement between VNH and its affiliate is “unjust and unreasonable” in that it removes the lucrative profits of the Yellow Page advertising operation from ratepayers and transfers those profits to the shareholders. In order to remedy this unfair arrangement the Commission must impute Yellow Pages revenues to VNH and use that imputation for future rate cases.

Respectfully submitted

OFFICE OF CONSUMER ADVOCATE

Dated: March 5, 2004

F. Anne Ross
Susan Weiss Alexant
William E. Homeyer

⁶⁵ Qwest Communications International, Inc., No. SPU-02-15, p. 3 (Iowa U.B. Sept. 4, 2002).